



Branchless Banking and Consumer Protection in Brazil

December 2009

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Executive Summary

As part of its Global Policy Initiative, CGAP¹ partnered with the Central Bank of Brazil (CBB) in late 2008, to learn more about the issues and trends in consumer relations when financial services are delivered through branchless banking, particularly through agents in ever increasing scale. This report highlights some of our findings.²

Three other countries with relevant experience in branchless banking (Kenya, Peru, and India) participated in a similar exercise at approximately the same time. As in the case of Brazil, the exercise gave regulators in each jurisdiction the opportunity to review their regulatory and institutional framework for protecting branchless banking users, evaluate their regulatory and supervisory actions, and identify areas for improvements.

A CGAP Focus Note complements the effort by making an overall evaluation of the lessons learned in these countries, as well as of evidence from other pioneer countries, such as South Africa, Mexico, Colombia and the Philippines. The Focus Note points out priority areas of concern and possible regulatory and policy options to address them.³

CBB and CGAP coordinated closely to gather data and information and to write this report.⁴ The first section of this report outlines the current state of play regarding the agency business. The following section summarizes the most important points of the legal and regulatory framework for financial consumer protection, emphasizing issues of particular importance for branchless banking. The report then presents the issues and problems identified in the relationship between branchless banking clients and providers, and supervisory and enforcement considerations. The last section introduces conclusions and recommendations for achieving a balance between openness to innovation and protection in a branchless banking environment.

¹ CGAP is an independent policy and research center dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty. Housed at the World Bank, CGAP provides market intelligence, promotes standards, develops innovative solutions, and offers advisory services to government, microfinance providers, donors, and investors. Its mission is to build efficient and equitable local financial markets that are integrated into the mainstream financial system and that serve all the unbanked, including very poor and harder-to-reach clients, with ever more innovative, convenient, and affordable financial services. For more information about CGAP, visit www.cgap.org.

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³ —Branchless Banking and Consumer Protection: Issues and Policy Options: CGAP Focus Note, forthcoming.

⁴ The data were collected by the Central Bank of Brazil from financial institutions, analyzed, and provided to CGAP only in a consolidated basis. CGAP had no access to information of individual financial institutions.

Contents

1	The branchless banking business and regulation.....	4
1.1	The branchless banking business	4
1.2	The agency regulation.....	8
2	Framework for financial consumer protection	10
2.1	Consumer Protection Code	10
2.2	Consumer protection rules and principles	11
2.2.1	Price suitability, transparency, and disclosure	11
2.2.2	Protection of client's funds.....	13
2.2.3	Protection of client's personal data	14
2.2.4	Marketing	14
2.2.5	Customer service and grievance resolution	15
3	Branchless banking and consumer protection	17
3.1	Regulatory approach.....	17
3.2	Identified consumer issues in the agency business	18
3.3	Other issues affecting branchless banking users	20
4	Supervision and enforcement: Preventive and corrective measures	20
5	Conclusions and Recommendations	21

1 The branchless banking business and regulation

1.1 The branchless banking business

The use of electronic channels (branchless banking) for conducting retail financial transactions is continuously growing in the Brazilian banking sector, although cash continues to be the preferred medium for low-value payments and the check remains an important payment instrument. Over 90 percent of the total noncash bank retail payment transactions in 2008 were processed via electronic channels, with increased use of the card as a payment instrument. The number of automatic teller machines (ATMs) and point-of-sale (POS) devices per 100,000 inhabitants (40.5 and 1,667, respectively) is significantly higher than it is in most Latin American countries, but the number is still below the average in industrialized economies.

Table 1: Distribution channels in selected countries (per 100,000 inhabitants)

Country	# Branches	# ATMs	# POS
Brazil	9.5	40.5	8,320 ^(a)
Chile	11.3	36.9	300.54
Colombia	9.5	17.5	206.41
Ecuador	8.6	9.0	
El Salvador	6.4	17.6	
Peru	5.9	9.1	
Venezuela	12.4	17.9	
Average developed countries	30.6	64.3	

Source: Felaban (2009).

(a) As of December 2007: Central Bank of Brazil, “Diagnostico do Sistema de Pagamentos de Varejo do Brasil. Adendo Estatístico—2008. Versao Preliminar de 27 de abril de 2009.”

Internet and mobile banking—offered by any large retail bank—give access to a wide range of services, such as transfers, investment funds, and bill payments. No other country in Latin America has such high penetration of Internet banking among the adult population (nearly 28%), and few countries globally offer such a wide range of Internet banking services.⁵ The number of Internet banking accounts currently totals 32.5 million, from only 8.3 million in 2000.⁶ Internet and mobile banking are restricted to previously existing account holders—i.e., banks do not use this channel to open new accounts. Regulation does not permit banks to open accounts without the client’s physical presence at a branch or a retail agent.⁷ Despite this restriction, the total number of bank accounts in Brazil has doubled between 2000 and 2008, from 63.7 million to 125.7 million.

In remote or urban areas where the focus is lower income segments, bank presence is usually guaranteed by the use of agents (locally known as correspondents). There are approximately 118,000⁸ correspondents throughout the country delivering financial services on behalf of fully licensed financial institutions..

Banks started using correspondents in the 1970s, and the relevance of this channel has increased considerably ever since, particularly after 1999 when important regulatory

⁵ Felaban Dados do setor bancario, 2009.

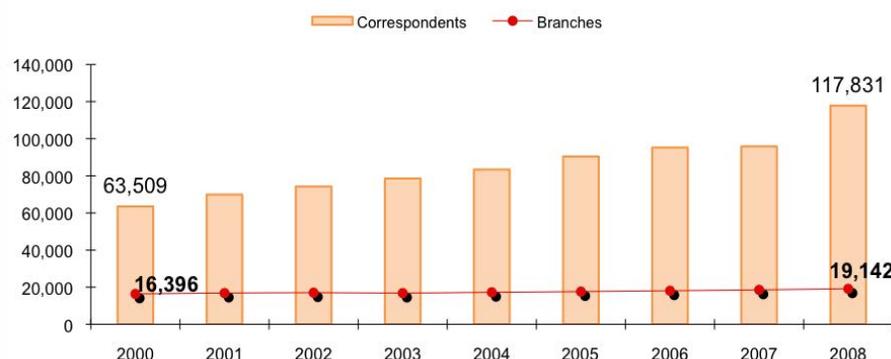
⁶ Ibid.

⁷ Exceptions apply. For instance, an existing account holder may open another account with the same bank or another completely through an electronic channel, such as the Internet (Resolution CMN 2,817/2001).

⁸ CBB, as of January 2009.

changes broadened the range of services that could be provided by agents and lifted all restrictions on the agent business and location. Today, correspondents represent approximately 62 percent of the total number of points of service of the financial system.⁹ Graph 1 shows that the number of correspondents grew 85.5 percent between 2000 and 2008, while the number of branches grew only 16.7 percent in the same period.

Graph 1: Use of correspondents and branches over time



Source: Central Bank of Brazil, as of January 2009.

Table 2 lends another perspective. In the same period, the Brazilian population grew 8.3 percent versus a growth 85.5 percent in the number of correspondents. In 2000 there was 1 correspondent for every 2,674 inhabitants; the proportion improved to 1:1,561 in 2008. The number of bank branches per 1,000 inhabitants, a measure internationally used to assess financial services availability, seems to be losing relevance in Brazil in the face of the ubiquity of correspondents. It no longer reflects the geographic reach of the banking sector.

Table 2: Growth of correspondents and total inhabitants

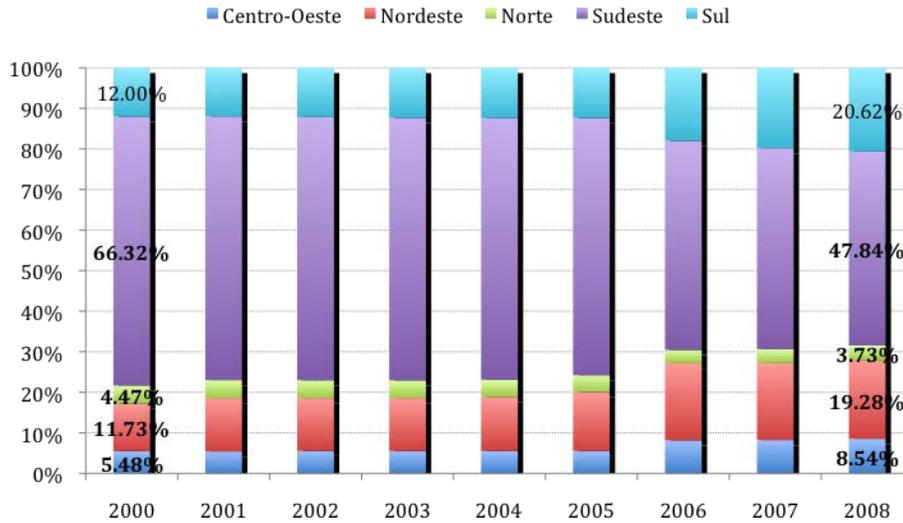
Region	# inhabitants per #correspondents 2000 / 2008	Variation 2008/2000 # correspondents	Variation 2008/2000 total population (estimation)	
Northeast	6,408	2,268	204.9%	7.9%
North	4,547	3,317	54.9%	13.0%
Midwest	3,342	1,314	188.9%	13.6%
Southeast	1,719	1,381	33.8%	7.5%
South	3,293	1,100	218.7%	6.5%
Total Brazil	2,674	1,561	85.5%	8.3%

Source: CBB, as of January 2009 and the Brazilian Institute of Geography and Statistics.

Another interesting indicator is the geographic concentration of correspondents: 47.84 percent of them are located in the wealthiest and most populated region (Southeast), where 42.3 percent of all Brazilian live. However, Graph 1 shows that correspondents are now spreading faster in the Northeast (considered the poorest region) and in the affluent South (another affluent region).

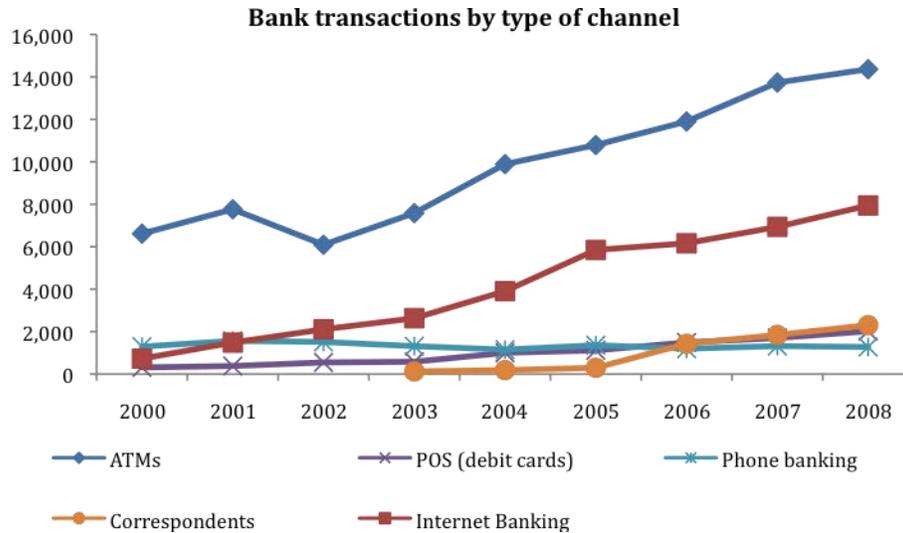
⁹ Febraban, —Dados do setor bancário, 2009.”

Graph 2: Geographic concentration of correspondents by region, over time



Source: CBB, as of January 2009 and the Brazilian Institute of Geography and Statistics.

In terms of systemic relevance, correspondents conducted 2.3 billion transactions in 2008.¹⁰ This represents 5.24 percent of the 43.9 billion total bank transactions, up from 4.75 percent in 2003.¹¹ Branch transactions, which used to represent around 20 percent of all bank transactions, now represent only 10 percent.



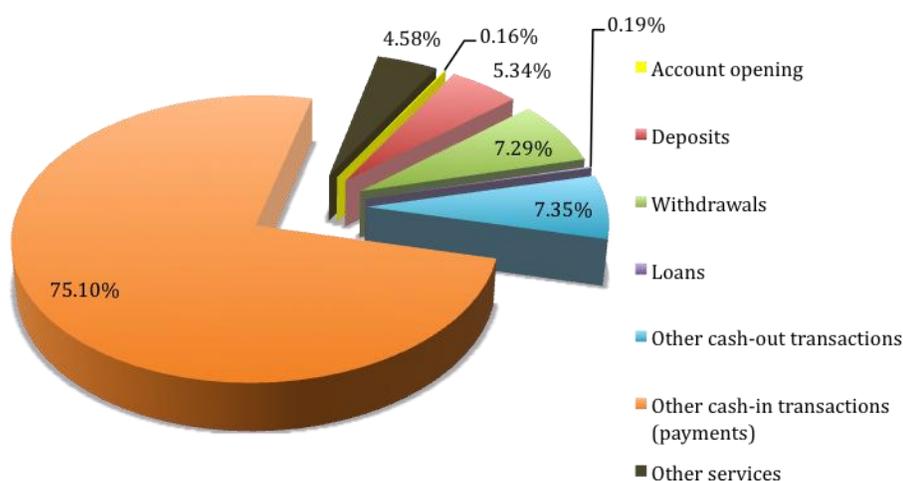
Source: Febraban, —Dados do setor bancário, 2009.” Note that data for Internet banking include both natural and legal persons. Roughly, each of these represents half of the total number of Internet banking transactions.

¹⁰ Febraban, —Dados do setor bancário, 2009.”

¹¹ Ibid.

Several types of services are offered, from bill payments to account opening procedures, but less than 30 percent of the correspondents handle bank accounts.¹² Most specialize in receiving bill payments, which accounts for approximately 75 percent of all agent transactions (47 percent of which are payments of utility bills).¹³ Withdrawals and deposits account for 12.6 percent and are nearly equally divided into savings and current accounts (including simplified accounts). Only 0.16 percent of the transactions are account opening; 7.3 percent are government transfers.¹⁴ Caixa Economica Federal is the leader in opening accounts in its 13,712 lottery outlets.¹⁵ Correspondents in the poorest regions (North and Northeast) specialize in bill payments and welfare payments, while those that also receive loan applications are more preponderant in wealthier regions.¹⁶

Graphic 3: Types of transactions conducted by correspondents



Source: Data provided by Febraban; accumulated from January to June 2008. As these data are provided by Febraban, they do not count nonbanks. Hence, the importance of loan origination, which is high among nonbank financial institutions, is diminished in this chart.

Correspondents usually are commercial establishments, but financial institutions may also be correspondents. The most common types of agents that conduct bill payments are supermarkets (10%), pharmacies/drugstores (9.4%), and lottery houses (8.3%).¹⁷ Car dealers are the most common (21%) among those that focus on distributing loans. In general, a diverse array of businesses act as correspondents.

¹² CBB, Financial Inclusion Project.

¹³ Data provided by Febraban (accumulated from January to June 2008).

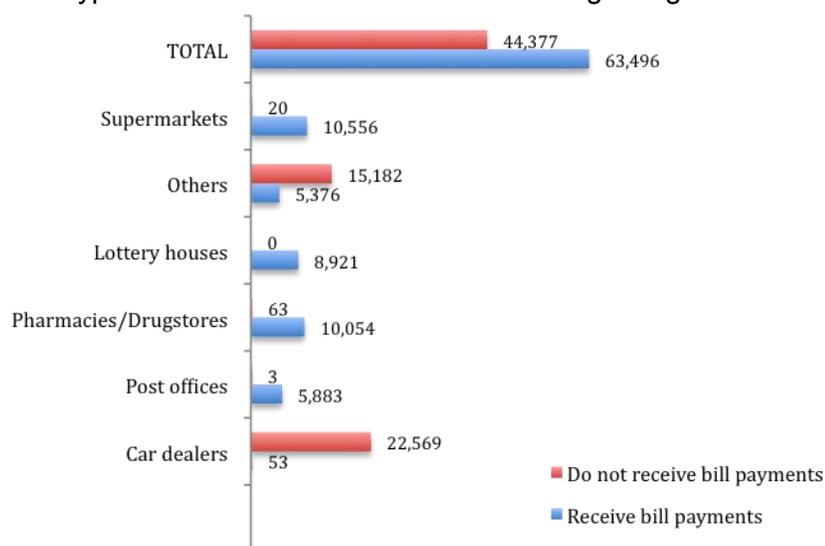
¹⁴ Ibid.

¹⁵ CBB, as of January 2009.

¹⁶ Ibid.

¹⁷ Data provided by Febraban, as of June 2008.

Graphic 4: Types of commercial establishment acting as agents



Source: Data provided by Febraban, as of June 2008. Note that the use of pharmacies and drugstores as agents is currently being questioned by the National Health Surveillance Agency.

1.2 The agency regulation

BCB Circular 220/1973 permitted banks to establish special service-level agreements with legal persons for collecting and payment services conducted on behalf of the banks. At this point, correspondents were not allowed to offer other services, such as loan applications and deposits, and there was no need of previous authorization by CBB.

In 1990, within the Federal Deregulation Program and in line with the creation of universal banks, some types of financial institutions were allowed to hire other financial institutions as correspondents.¹⁸ This measure aimed at extending services to bank clients in areas where that bank did not have a branch. This is the traditional definition of “correspondent bank” used throughout the world. As such, branchless banking in Brazil began before the modern concept of correspondent bank was adopted.

Later, CMN Resolution 2,640/1999¹⁹ better defined and broadened the range of services that correspondents could deliver, although not all types of financial institutions could use them:

1. Receiving and forwarding account (savings and demand) opening applications
2. Payments and deposits in savings, investments, and demand accounts
3. Third-party payments (bill payments)
4. Payments and deposits for the bank itself
5. Receiving and forwarding loan applications
6. Analysis of credit and background information
7. Collection services
8. Control and data processing related to the transactions conducted through the agent

¹⁸ Resolution CMN 1,764/1990, altered by Resolution CMN 1,865/1991.

¹⁹ This BCB Circular revoked Circular 220/1973.

9. Other activities authorized by CBB

Services in items 1 and 2 were subject to previous authorization of CBB, while the other items required only registering. CMN Resolution 2,640/1999 permitted items 1 and 2 to be provided exclusively in municipalities where there was no bank presence at all. This excluded the possibility to install an agent even in localities where there were only simpler types of bank establishments (locally known as “posts”).²⁰ Moreover, if a branch was later installed in such localities, the bank was obliged to close down the correspondent in 180 days. Such restrictions did not improve service quality and availability, and they discouraged competition for new markets. For these reasons, Resolution CMN 2,707/2000 was issued to eliminate these limitations to the agency business.

Note that Circular BCB 2,978/2000 determined accounting procedures of agent transactions, which must be grouped by locality and controlled by the closest bank branch. This regulation also was important for clarifying that the bank must observe the legislations related to bank secrecy, physical security, and anti-money laundering legislation.

New improvements in the regulatory framework for the correspondent business were introduced by Resolution CMN 2,953/2002, which made it clear that, although the correspondent can receive and analyze account-opening applications as well as conduct customer due diligence (examine identification documents), the provider (the bank) will always be responsible for ensuring compliance with all applicable regulations.

The accumulated regulatory experience, the increasing success of the correspondent model, and in particular, the financial inclusion policy adopted by the central government all led to further regulatory improvements through Resolution CMN 3,110/2003²¹ and Resolution CMN 3,156/2003 (both in force today), which introduced the following innovations:

- All types of financial institutions can now hire correspondents, including credit cooperatives and microcredit institutions
- Any type of commercial establishment or financial institution can be a correspondent
- Correspondents can now receive and forward credit card applications
- Correspondents engaging in items 1 and 2 above cannot have the agency business as its main activity
- Agency agreements between a financial institution and a correspondent can be subcontracted, with previous consent of the contracting financial institution
- Agency agreements must have some minimum clauses established in the Resolution

²⁰ Bank Assistance Post (Posto de Atendimento Bancário) is a bank establishment that can provide all services that a bank branch offers but can be installed only inside government buildings or private companies and is subordinated to a bank branch or the bank headquarters. The Advanced Assistance Post (Posto Avançado de Atendimento [PAA]) is a bank establishment that can be installed only in localities that lack any bank presence and has some unique characteristics: demand deposits collected by PAA are exempted from reserve requirements; as opposed to branches, business hours and services are freely set by the bank; the building can be rented; and the bank may install, in the same locality, an Electronic Banking Assistance Post (Posto de Atendimento Bancário Eletrônico).

²¹ Revoked Resolution CMN 2,707/2000.

- Commercial establishments are legally prohibited from acting as agents or providing financial services without having an agency relationship with a financial institution, according to the bank law (Law 4,595/1964, art. 44, § 7)

In response to demands from financial institutions, Resolution CMN 3,568/2008 permitted correspondents to offer international transfers on behalf of a financial institution, limited to US\$3,000 per transaction, subject to a simple register in CBB. This measure aimed at increasing competition in and reducing costs of small foreign exchange transactions, which are considered very high in Brazil.²²

The latest innovation toward simplification of agency regulation came in December 2008, with Resolution CMN 3,654/2008. This Resolution lifted the need of previous authorization for all types of services conducted through correspondents. Today, any financial institution willing to deliver services through correspondents needs only to register each new point in CBB's information system.

2 Framework for financial consumer protection

2.1 Consumer Protection Code

The Consumer Protection Code (CPC)²³ is an encompassing law that establishes rules and principles for consumer-provider relationships to protect consumers who acquire products and/or services in all industries. The law is enforced by the National Department for Consumer Protection and Defense (known as Procon), a government body under the Ministry of Justice that uses a decentralized network of local bodies widely recognized by the general public. Procon receives and treats complaints from all industries, from dentists to shoemakers, from cars to financial services, because it is responsible for monitoring consumer relations and has the authority to impose administrative sanctions, which include fines, products recall, and intervention to commercial establishments.

CPC defines consumer as –any natural or legal person who acquires or uses a product or a service in the condition of final recipient.”²⁴ A collective of people that intervenes in a consumer relationship also can be considered a consumer. Services are defined as –any activity provided in the consumer market, in exchange of remuneration, including those of a banking, financial, credit or insurance nature”.²⁵ Based on this provision, one would conclude that all principles and rules set forth in CPC would be strictly applicable to relationships between financial institutions and their clients/users.

In response to consistently large numbers of complaints registered against financial institutions (mostly banks) in the Procons and with CBB, Resolution CMN 2,878/2001 (formerly known as –Bank Client Protection Code”) was issued. The Resolution was enacted after an extensive process of public consultation, with the purpose of

²² Note that correspondents receive/deliver domestic currency only. They are not permitted to handle foreign currency. The foreign exchange transaction itself is conducted by a licensed financial institution, which is also responsible for anti-money laundering procedures, including setting limits for the number of this type of transaction that each correspondent can conduct.

²³ Law 8,078/1990.

²⁴ Law 8,078/1990, art 2.

²⁵ Law 8,078/1990, art 3.

establishing business rules to govern the specialized relationship between banks and their clients/users and making enforcement easier by placing it under the auspices of CBB.²⁶ The main pillars of this Resolution, based on CPC, were transparency and fairness (service quality, fair treatment, redress, and nondiscrimination between clients and nonclients [i.e., users]).

Nonetheless, there has been a lot of controversy over the extent to which CPC applies to financial services (and therefore the agency responsible for enforcement and the boundaries for its actions). For instance, it was not clear whether CBB had legal authority to enforce compliance with CPC rules and principles, and the issuance of the Bank Client Protection Code did not solve this imbroglio. The matter was the subject of several positioning documents from CBB's legal department and from the General Attorney. The current understanding is based on these documents: CBB will limit its supervisory role to issues that are specific to financial services and not covered by CPC. Procons will cover all other issues that are dealt with by CPC.

Although this definition is not crystal clear, it is understood by the main regulatory bodies that CBB responsibility excludes, for instance, physical security (on the Ministry of Justice's portfolio) and the solving of specific grievances between a financial service provider and a consumer (on the Procon's portfolio). Based on the current interpretation, the Bank Client Protection Code was revoked and currently CBB limits its enforcement efforts to a set of regulations: Resolution CMN 3,477/2007²⁷ (ombudsman services), Circular 3,359/2007 (ombudsman for financial consortiums), Resolution 3,516/2007 (early liquidation of loans), Resolution 3,518/2007 (fees and charges), and Resolution 3,517/2007 (transparency). The main points of such a regulatory framework, as well as some principles set in CPC, are presented in the next section.

2.2 Consumer protection rules and principles

2.2.1 *Price suitability, transparency, and disclosure*

The basic consumer rights guaranteed by CPC include²⁸ (i) education and dissemination about the correct use of products and services; (ii) freedom of choice; (iii) adequate and clear information about the product/service characteristics, price, and risks; (iv) protection against misleading advertising; (v) redress; and (vi) inversion of the burden of proof against the provider.

On price suitability, Resolution 3,518/2007 sets detailed rules for the charging of fees²⁹ for the services provided by regulated financial entities to their clients. It is important to make this difference, because this Resolution does not cover users, i.e., nonclients. For this purpose, the Resolution defines clients as those with whom the financial institution has a nonsporadic relationship, originated by deposit, loan, leasing, service provision, or investment agreement. It states that any charge must be linked to a service that was previously authorized or requested by the client and, whenever applicable, must be

²⁶ Altered by Resolution CMN 2,892/2001.

²⁷ Altered by Resolution CMN 3,489/2007.

²⁸ CPC, art. 6.

²⁹ These requirements are not applicable to third-party costs and expenses. For example, the bank may require the client to reimburse expenses related to services of a loan collection firm used to recuperate delinquent credits, provided that such possible charges are previously stated in the contract.

specified in the underpinning service level contract. In addition, account holders (savings and current accounts) are entitled to receive, by end of every February, a free statement detailing all fees charged in the previous year to a given account.

In regard to the charging of fees, the Resolution classifies banking services to clients (individuals only) into the following:

1. Essential
 - a. *Some current deposit account services.* Provision of a debit card; provision of 10 checks per month; replacement of the debit card (when the reason for replacement is not imputable to the client); up to four withdrawals per month at branches or ATMs; up to two monthly statements in ATMs; and two transfers to accounts in the same bank (via branches, ATMs, or Internet); and check clearing
 - b. *Some savings account services.* Provision of an account card; replacement of the card (when the reason for replacement is not imputable to the client); up to two withdrawals per month at branches or ATMs; up to two transfers to accounts of the same holder; up to two monthly statements; and consultations through the Internet
2. Priority. These services are defined by Circular BCB 3,371/2007, which creates standardized nomenclatures for them, their distribution channels, and respective acronyms to be used in the account statements.
3. Special. These are services linked to government credit programs (rural, housing, pension, taxes), simplified accounts, salary and pension accounts, and the directed microcredit program.
4. Differentiated. Several services, such as investment fund management, safe rental, credit cards, special account statements, and others.

Essential services must be compulsorily provided, free of charge. Priority services may be charged only if the service and its nomenclature are listed in Circular BCB 3,371/2007—i.e., if there is no regulatory provision for the service, it cannot be charged. These requirements do not apply to special services, which have specific and often more stringent rules.³⁰ Lastly, providers may freely charge for differentiated services, given that the fee and the charging method are defined in the contract.

On top of that, providers must offer to their clients (individuals) standardized monthly packages of priority services whose content (services and number of transactions) is defined by Circular BCB 3,371/2007. The price for each package cannot be higher than the sum of the individual services it contains (the regulation establishes some rules for determining the price of the packages). The client must have the option to incur individual services, in case she prefers not adhering to a package.

In any case, all debits linked to fees can be registered in a bank account (savings or current account) only if there is sufficient balance to cover it. (The fee may be charged as soon as there is available balance.)

³⁰ Resolution 3,211/2004 governs simplified (special) accounts while Resolution 3,402/2006 (altered by Resolution 3,242/2006) governs salary accounts. Resolution 3, 422/2006 requires commercial banks to earmark 2% of their demand deposits to microcredit operations. Interest rates and charges on these operations are capped by this regulation.

Regarding loans (including overdraft) and leases for natural persons, Resolution 3,517/2007 requires providers to, previously to the consummation of the operation, inform the annual effective cost (CET) calculated according to a standardized formula set in the same Resolution, which includes costs in addition to the interest rate. The disclosure of CET (which also includes giving the spreadsheet with the calculation to the client) follows a format defined in the Resolution. Clients have the right to request the calculation of CET at any given time. All marketing materials must inform both CET and the effective interest rate. Moreover, the historic series of CETs must be kept for at least five years.³¹

Resolution 3,516/2007 prohibits financial institutions from charging fees in case of early liquidation of a loan or leasing contract when the borrower/lessee is an individual or a micro or small enterprise (defined as per Complementary Law 123/2006). The discount rate, determined according to rules set in this Resolution—which differ for short- (up to 12 months) and long-term loans/leases (over 12 months)—must be disclosed in the loan/lease contract. Any additional fee or charge that was included in the financed amount should be discounted at the same rate.³²

Increase or creation of fees must be previously communicated to the client and the general public, with a minimum of 30 days notice. Fees related to priority services and packages can be increased only after 180 of the last increase. All increases must be communicated to CBB as soon as they occur.

The following information must be posted in visible signs in bank facilities, its retail agents (correspondents), and the entity's Internet portal:

1. Services free of charge (essential, plus some special services)
2. Charged services, their distribution channels, acronyms used in statements, and respective fee
3. All necessary information about the standardized service packages
4. Clarification that the prices were established by the institution itself

2.2.2 Protection of client's funds

The Credit Guarantee Fund (Fundo Garantidor de Crédito [FGC]) was created in 1995 through Resolution 2,197/1995³³ to protecting bank creditors in the event of (i) intervention, liquidation, bankruptcy, or acknowledgment, by CBB, of the institution's insolvency (ii) and other situations agreed between CBB and FGC. The maximum guarantee per person per insured institution (or banking conglomerate) is R\$60,000.³⁴ Demand, time, savings, and other deposits are covered. Credit cooperatives are not covered.

³¹ All these requirements do not apply to directed credit programs.

³² Note that the requirements set by Resolution 3,516/2007 are not applicable to directed credit imposed by the government, such as rural credit, and special credit programs of the government development bank (BNDES).

³³ Resolutions 2,211/1995.

³⁴ US\$30,000 (exchange rate USD/BRL=1:2).

There are no specific regulations regarding the safety of funds deposited in electronic money services provided by nonbanks, e.g., prepaid accounts stored in plastic cards. However, currently there are no relevant services of the type.

2.2.3 Protection of client's personal data

There is no specific data protection and privacy law in force in Brazil, contrary to what we observe in Peru and Argentina, for instance. The general principle of data privacy and protection is generally drawn from the Federal Constitution,³⁵ CPC, and in some instances the Civil Code. Data collection and handling receive a more specific treatment in CPC and the Habeas Data law, but there is no specialized credit bureau law. Within the financial sector the most important legal document is the Bank Secrecy Law³⁶ that financial institutions will preserve secrecy in their active and passive operations and services. Broad exemptions exist, including information exchanged between financial institutions for cross-checking of client identification information only, reporting of information requested by the Federal Revenue Service, and reporting of illegal activity to the appropriate authorities. In addition, confidentiality can be breached when necessary to confirm suspicion of any illegal activity in any phase of an inquiry or action at law.

According to a 2007 study conducted by CGAP in Brazil,³⁷ financial service providers consider the lack of a comprehensive legal framework for data privacy and crimes related to electronically authorized transactions to be a great obstacle for electronic commerce and a threat to consumer privacy, because criminals sometimes do not see serious consequences of their wrongdoing. There has been an escalation of e-security crimes (identity theft, phishing, spam, and viruses); some successful prosecutions brought charges by combining provisions of the Penal Code (which defines few infractions related to manipulation/alteration of personal data), the wiretapping law, and the bank secrecy law, resulting in a very slow and costly process. Approximately 15 draft laws on electronic crimes are currently under analysis in Congress.

2.2.4 Marketing

CPC prohibits any type of misleading or abusive marketing or publicity and defines these terms, including when a marketing material is misleading by omission of relevant information.³⁸ Tied sales and unsolicited services are prohibited.³⁹ According to Law 8,137/1990, art. 7, VII, it is a crime against consumer relations to lead the consumer to err, through false or misleading information regarding the nature and quality of the service or good, by any means, including public dissemination or advertising.

³⁵ Federal Constitution, Art. 5.

³⁶ Complementary Law 105/2001.

³⁷ CGAP (2008). —Notes on Regulation of Branchless Banking in Brazil.”

³⁸ CPC, art. 37.

³⁹ CPC, art. 39. Tied sales occur when a provider imposes the purchase of a product as a precondition to access another product. For instance, when a client is required to buy life insurance in order to get a loan.

2.2.5 *Customer service and grievance resolution*

Financial institutions' ombudsmen

All licensed financial entities are required to have an internal ombudsman to deal with complaints that are presented by customers and not solved by the customer service area or staff at the various points of service (including agent points). A director must be in charge of this service and the ombudsman's staff. The director also is responsible for liaising with CBB in these matters. Ombudsman staff must pass specific exams offered by accredited institutions.⁴⁰ The ombudsman's existence, role, and procedures must be widely advertised (including in the means and channels used to advertise the financial services), and complaints must be solved within 30 days, free of charge. Ombudsmen may vary in complexity and size according to the complexity of each provider,⁴¹ but all retail institutions (those serving individuals and microenterprises) are required to set up a toll free telephone line at a minimum.

Other ombudsman functions include ensuring compliance with rules and principles set forth in CPC and proposing improvements in service provision to the board (if there is no board, to the management). The ombudsman's semi-annual reports are presented to management, the internal auditor, and the audit committee (if one exists), and they must be kept for at least five years, for supervisory purposes. In addition to these internal management reports, the director must produce semi-annual standard reports to be presented to CBB (within 60 days of the end of each semester), which contain the opinions of the external auditor vis-à-vis the ombudsman's structure, systems, and procedures. The audit committee, if there is one, and the internal auditor must sign off on these reports.⁴² Any relevant fact that occurs or is identified between reporting dates must be communicated to CBB by the director within 60 days.

To allow for this level of analysis, financial institutions must set up control systems that promptly identify all complaints; how they were solved; the services, products, and clients involved in the complaint; as well as the supporting documentation. All this must be kept for at least five years.

It is worth noting that a recent measure changed several aspects of phone-based customer service in regulated industries, including financial services. Some of these aspects are as follows.⁴³

- Complaints must be solved in five days.
- There must be a toll free telephone line; the calls must be recorded, and the records should be available to the customer for at least 90 days.
- The first automated menu must give the option for speaking with a representative, file a complaint, and cancel the service/contract; all other menus must give the option to speak with a representative.

⁴⁰ The Resolution specifies that such exam must cover, at a minimum, topics from business ethics, consumer rights, and conflict mediation. Staff must be certified by July 2009 (two years after the Resolution came into force). Such courses are currently available, for example, at the Federation of Brazilian Banks (FEBRABAN).

⁴¹ The Resolution permits the outsourcing of call center activities to common structures at industry associations of brokers and broker-dealers. The ombudsman function, however, cannot be outsourced.

⁴² Microcredit institutions (sociedades de crédito ao microempreendedor) are exempted from pursuing the opinion of the external auditors on this report. Also, while there is no standardized report for the internal auditors in this matter, Febraban is developing a template that would be used.

⁴³ Decree 6,523/2008.

- The service must be available 24 hours a day.
- The service must keep available to the customer a historical of all previous enquiries.
- The customer must be connected to the responsible area according to his enquiry in no more than 60 seconds.
- Customer's data can be used only for customer service activity.

Consumer protection bodies

As mentioned earlier, the federal government also has instituted a network of general consumer protection bodies, commonly known—and widely recognized by the general public—as Procons. Procons are local government bodies (at state and city levels) that are affiliated to and follow the policies and principles set by the Department of Consumer Protection and Defense, which is housed at the Ministry of Justice. Procedures for filing complaints vary across states and cities (only the larger cities have their own Procon, while smaller cities usually rely on the Procon located at the state capital). However, making a complaint or an enquiry is generally easy.

The complaints registered at Procons receive different treatment according to their type and the necessary follow-up procedure, which varies from a mere call to the provider to the characterization of a formal complaint to the provider. The former is an administrative process targeting urgent and more complex problems presented by the consumer. When the provider of the financial service is perfectly identified (which might not be immediately possible for all cases), the complaint is forwarded directly to the financial institution. In general, larger institutions have dedicated staff who specialize in dealing with complaints received by Procons.

The Procon network compiles its complaint information in a system (Sistema Nacional de Informações de Defesa do Consumidor), whose consolidated data is accessible by any person via the Internet. Between 2007 and 2008, this system registered 15,175 complaints related to financial institutions (16.2% of all complaints received).⁴⁴ This system has a major shortcoming: excluding the state of Sao Paulo, where the bulk of the financial system is located. Only when Sao Paulo is integrated (a measure planned to happen by 2010) one will be able form a clear picture of the main issues in consumer relationships in the national financial system.

The role of the Central Bank

Based on a set of overarching guidelines applicable to public services in general,⁴⁵ CBB has set up a specialized team to deal with demands from the general public (Central de Atendimento ao Público), more specifically providing information to and solving questions presented by financial consumers. The intended function of this structure is to ensure compliance with CBB's regulations, rather than solve disputes between clients and financial institutions. Despite this, many seek this service to register complaints against financial institutions.

Complaints received by this team are registered in an information system (Sistema de Registro de Denuncias, Reclamacoes e Pedidos de Informacoes) that was developed by

⁴⁴ <http://www.mj.gov.br/SindecNacional/reclamacao.html>

⁴⁵ http://www.bcb.gov.br/Pre/bc_atende/port/politica.asp?idPai=PORTALBCB

CBB to monitor the measures adopted by financial institutions to resolve each case.⁴⁶ This information, which includes the written response given to the customer, is entered into the system by the institutions themselves. In this manner, CBB acts as a facilitator and enforcer. CBB also posts monthly on its Web site a ranking of the institutions by the number of complaints they receive and the topics that generate more complaints.

In 2006 CBB created its own ombudsman to receive complaints, critiques, suggestions, and compliments regarding its own activities and fulfillment of its mission and responsibilities. It seems that awareness of this service and its function is still rather low, as evidenced by the small number of registered cases in 2007 (2,695, up from 644 in 2006). Of these, 1,950 were complaints, 361 were suggestions, and 295 were compliments.

No regulatory provision requires financial institutions to disclose information about consumer complaints nor are there standardized formats or definitions to classify complaints received by the consumer service team (Serviço de Atendimento do Cliente) to facilitate analysis and disclosure by CBB. Contrarily, the ombudsmen services follow a standard classification of issues defined in the regulation,⁴⁷ which is also used in the report submitted to CBB, twice a year. CBB does not make ombudsmen complaint information public.

Presently, given the way different complaint filing channels coordinate, such information leads to distorted interpretations by the public and the media. Although the existence of multiple complaint filing channels increases customer convenience and the probability of resolution, it distorts the total numbers, because consumers very often register the same complaint in all redress channels at the same time, and there is no mechanism to avoid double counting. In addition, Procon's procedures increase the chances of double counting, because Procon may send follow-up requests to both CBB and the financial institution in relation to a single complaint.

Brazilian financial consumers are still learning about different redress mechanisms and how to use them. CBB believes that a major contribution to this process is the regulatory provision requiring financial institutions to disclose the existence, functions, and procedures of their ombudsmen in their advertising materials.⁴⁸ With regard to multiple registers, CBB's Web site recommends that the client first try to solve his or her problem with the provider and to seek help from consumer protection bodies only if the case was not addressed satisfactorily. Febraban is working on a major awareness campaign launched in March 2009. Of course, none of these initiatives will solve the problem of concomitant registers in CBB and Procons.

3 Branchless banking and consumer protection

3.1 Regulatory approach

Consumer protection laws and regulations make no distinction between branchless banking clients and branch clients in regard to applicability—i.e., requirements and

⁴⁶ This system also registers complaints and suggestions regarding CBB itself, as well as general consultations. The same team is responsible for giving feedback on such cases.

⁴⁷ BCB Carta-Circular 3,298/2008.

⁴⁸ CMN Resolution 3,477/2007, art. 1st, para 5.

principles apply in the same way to branchless banking as they do to traditional channels. However, given the singularity of the agency business, which involves third parties and their staff, CBB has issued specific regulations to deal with and clarify some consumer-focused issues. First, and most important, Resolution 3,110/2003 holds the financial institution fully liable for services provided through correspondents and for their acts. Should fraud be conducted by a correspondent, the bank will be responsible for covering losses and damages caused to consumers, although it will have recourse against the correspondent. This liability is set not only in regulation, but it also has a legal base in CPC, which states that the provider is jointly liable for the acts of their agents or autonomous representatives.⁴⁹

Second, the retailer is required to post a visible sign in its facilities clarifying its condition as no more than an intermediary between the financial institution and the client. The Resolution also prohibits correspondents from providing cash advances based on a financial transaction that has not yet been approved or finalized by the financial institution.

On price transparency, Resolution 3,518/2007 specifically requires correspondents to post the applicable fees for all services provided in their facilities. On fairness, Resolution 3,110/2003 prohibits them from charging additional fees on their own (without the providers' consent). Finally, the principles of data privacy set by CPC are equally clearly applicable to branchless banking clients, and correspondents may face criminal and civil charges for not complying with bank secrecy rules.

Resolution 3,477/2007 requires financial institutions to post at "all service points" the telephone number for their ombudsman service. Service points clearly include correspondents. Although banks are liable for the conduct of their agents, clients have the right of redress against both provider and agent, because CPC keeps all jointly liable for disrespecting consumer rights.⁵⁰

3.2 Identified consumer issues in the agency business

As input for this report, in December 2008 CBB requested complaint information specifically with regard to correspondents, from 30 financial institutions, for the period of October 2007 to October 2008. The responses did not produce high-quality quantitative data, mainly because institutions do not segregate, in their complaint management systems, complaints that are related to correspondents.

It was not possible to classify the information received into types of problems or issues, because each institution has its own classification system, making it impossible to compare the data across different banks. Likewise, it was not possible to know how many complaints related to correspondents are represent in the total number of complaints received by financial institutions. CBB does not monitor the total number and types of complaints of the financial system as a whole. The reports about bank ombudsmen services sent to CBB semi-annually are standardized and divided into 13 themes (there is not a specific one for correspondents). Although such reports could be valuable for the purposes of this exercise, as mentioned earlier, they are not public information.

⁴⁹ CPC, art. 34.

⁵⁰ CPC, art. 6.

Notwithstanding, a wealth of anecdotal accounts was collected during interviews, revealing some interesting facts. First, CBB observed that there is great value in splitting complaints into two types:

- those originated in the relationship between client and agent
- those originated in the relationship between the agent and the financial institution (which affects the relationship between client and agent)

From this exercise, CBB concludes that complaints from agents are as valid as consumer complaints for probing and improving control mechanisms and business practices. Agents are active in contacting the provider to solve technical problems that may affect the service they provide to their customers. The main problem reported by agents is failures and slowness in the connection between the bank and the commercial establishment. Bad connection or other technical problems, such as lack of paper in the POS device, result in long lines and may affect the agent's own business.

Second, loans received the highest number of complaints by clients, followed by cases of bill payments that were not actually settled and lack of cash at agents. This is consistent with the fact that payments and loan origination are the most common transactions conducted through correspondents.

Other complaints classified as "bad service" include poor maintenance of POS equipments (e.g., lack of print paper) or other supplies. An interesting anecdotal account is that clients file complaints when the agent lacks office supplies to conduct its activities specifically to avoid the closure of the agent (since agents get dissatisfied for not being able to conduct financial transactions and generate fees).

The exercise also included interviews with financial institutions, consumer protection bodies, and bank associations. None of these shared quantitative data about complaints or problems, but provided a wealth of anecdotal accounts. Consumer protection bodies are primarily concerned with service quality, most of all, with the potential for overindebtedness as a result of large-scale loan origination by agents. Although this is not supported by empirical evidence, they argue that distorted compensation incentives have deteriorated underwriting standards.

Most of the interviewees agree that a major concern is loan fraud⁵¹ and unauthorized loan churning.⁵² Other problems mentioned by the interviewees or identified through CBB's supervisory review include the following:

- Lack of signage at agents about applicable fees, the agent's status, and the bank's customer service number
- Lack of signage at agents about the agent's status

⁵¹ Unauthorized loans mostly involve payroll loans to pensioners. To originate a loan without the borrower's consent, the agent uses several fraudulent steps, from unauthorized access and use of the database of the National Social Security Service (an e-security breach), to counterfeit signatures and forged phone calls. Then, the loan request is presented to a bank employee for approval. The pensioner may realize he is a borrower only when loan installments are deducted from his pension.

⁵² Churning a loan is when the agent (or individuals subcontracted by the agent) sells the loan to another financial institution, to create new fees from financial institutions. Many times—or most times—the borrower does not know the loan is being sold. Usually the loan contracts have small print, allowing the agent to "turn" the loan. If not, the agent may use fraudulent tactics to make it possible.

- Steering of credit and other services, by the agent, to collect higher fees
- Misuse, by the agent, of customer's personal information
- Charging, by the agent, of additional fees
- Agent frauds, especially insurance fraud
- Several types of operational and technical problems with equipment and communication with the bank, lack of cash at the agent, lack of paper to print the receipt, etc.

Also there are merchants that were not actual agents (i.e., they did not have an agency agreement with a financial institution) acting as such, which created problems and financial losses for clients and banks alike.

3.3 Other issues affecting branchless banking users

On top of specific problems in the relationship between client and provider, CBB and the banks operating through correspondents agree that labor issues constitute a severe threat to the viability of the correspondent business: labor unions demand equalization of pay and work conditions between agents and bank employees. In addition, there are several draft laws on private security that increase security standards for agents and branches alike. Both problems are multidimensional, because they are not only business related. They have legal and regulatory repercussions, including the issue of hierarchy of norms (a Resolution versus the Labor Code) and the regulatory definition of a correspondent. A disruption in the correspondent business could have disastrous consequences, particularly for low-income customers who rely on local commercial establishments to conduct their financial transactions.

4 Supervision and enforcement: Preventive and corrective measures

Supervision by CBB in any risk area has both a preventive and a corrective character, and it is not different in consumer protection issues. A specialized supervisory program prepared by a team of specialists targets the customer service structure and the financial services and products provided by each institution. Hence, CBB sees consumer protection as a risk supervised institutions need to monitor and control. The program is divided into three types of inspections or analyses:

1. Customer service. The objective is to evaluate the structure, procedures, and internal controls of the institution's customer service, as well as regulatory compliance and the institution's commitment with the providing good services to its customers.
2. Pricing. The objective is to verify regulatory compliance of pricing practices, through the analysis of fees and charges (including service packages and effective total cost of loans).
3. Ombudsman. The supervisory team focuses on the efficacy and efficiency of each institution's ombudsman service, relative to previous periods and to other institutions in the peer group.

This framework is also applicable to correspondent networks. CBB is so far the only banking supervisor in the world with specific supervisory procedures to assess the risks

of using retail agents, focusing on the evaluation of risk management and control processes of each financial institution with regard to its correspondent business. Based on this exercise, which saw that banks lack a systematic way to identify complaints and problems related to correspondents, this supervisory program was updated to include the evaluation of the complaint filling and redress procedures linked to correspondents, as well as the measures adopted by institutions to address identified weaknesses.

The supervision focuses on each institution's risk management policies and procedures, rather than on specific consumer protection issues across the financial system, i.e., CBB does not monitor the total number of and types of complaints related to correspondents in the financial system as a whole.

5 Conclusions and Recommendations

Bank-based branchless banking is flourishing in Brazil. Although Internet banking and ATMs are the most important electronic channels in terms of number of transactions, agents are the number one physical channel. By being a manned channel, agents present consumer protection issues that are not seen in purely automated channels, and are similar to those observed in branches. CBB is presently recognized as the global leader in regulating and supervising agents, having developed specialized supervisory procedures for such. CBB also has incorporated consumer protection as a risk area in its supervisory program.

Despite these positive developments and the overall belief by CBB and the industry alike, that branchless banking has achieved significant scale without major drawbacks and problems for the consumer, there are important opportunities to improve the enforcement of consumer protection principles and the ability of CBB to identify and address relevant consumer protection issues arising from the use of agents. Some measures are exclusively in the realm of CBB, while others require coordination with other actors, such as Procon and the bank associations.

First, the exercise showed that there is lack of quantitative data on the issues and problems arising from the use of agents by financial institutions. Financial institutions, even those with significant agent networks, are not able to promptly identify complaints that are originated by this channel or to provide numbers with regard to their nature and frequency. Hence, providers may be not entirely equipped to adequately treat generalized or serious isolated problems in their relationship with the consumers that use correspondents, in a timely and consistent manner.

Based on this, CBB has recently added, to the supervision program for correspondents, the evaluation of the systems and procedures put in place by each financial institution to receive and address complaints related to agents and identify and treat consumer protection issues in agents. The convenience and feasibility of imposing a regulatory requirement for financial institutions to segregate the agent channel in their complaint filing systems, or requiring regular reporting of such information to CBB for supervisory and disclosure purposes, is a topic that requires careful consideration by CBB's supervisory team, in coordination with the banking industry. At a minimum, bank associations should be able to monitor and disseminate information about the main consumer issues related to agents, to inform and educate customers, and to exercise pressure on banks to address weaknesses.

With regard to redress mechanisms, although the set up is flexible and convenient for customers, there is considerable room for improving the registering and treatment of complaints in financial services as a whole, particularly in what concerns coordination among different redress channels (CBB, financial institutions, and Procon). Double counting of complaints and overlapping of follow-up efforts by CBB and the Procons are weaknesses that suggest room for improvement. In addition to distorting statistics, concomitant registering of the same complaint in different entities frustrates attempts to identify the most common consumer protection issues in financial services, let alone in the agency business. The awareness campaign launched by the bank industry to have customers to first seek help from providers to solve their grievances, and the efforts of CBB in the same direction, are positive steps but do not solve the problem of double counting and the lack of consolidated complaint information. To address such shortcomings, the system would need to be able to identify active complaints in the name of a client in all redress mechanisms. A more controversial, less efficient, and more bureaucratic alternative, but surely less expensive, option that has been adopted in some countries is to require complainants to show that they have already brought the complaint to the provider before registering a new complaint. In the absence of a continuous source of complaint information, or in addition to one, a study on the types and frequency of consumer issues related to correspondents, including frauds and robberies, could be commissioned by CBB and/or bank associations.

Even more important than regulatory and coordination efforts is the need to deal with the current threats to the continuity of the agent: (i) labor union demands to equalize pay and work conditions between agent employees and bank employees and (ii) draft laws applying branch security requirements to agents, as well as regulations from other agencies such as the sanitary agency, questioning the model. If initiatives like these are successful, they could destabilize the underpinning business proposition of agents, by imposing excessive costs on banks. This would affect millions of customers who rely on local merchants to conduct their financial transactions. Possible solutions to this problem include regulatory reform to improve the definition of correspondents, as well as other measures that are not in the realm of CBB's legal authority but could benefit from its support, such as the issuing of a law to clarify the nature of the correspondent business, which is different from banking business.